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FY 1988 Budget: Outlays Up, Taxes Too

Japan's fiscal policy will continue to play a stimulative role in fiscal 1988 (starting April 1, 1988) if the government of Prime Minister Noboru Takeshita has its way. On December 28 the cabinet approved a 4.8 percent increase in the overall general account budget, the largest increase in initial spending plans in six years. In addition a 9.4 percent increase is planned for the Fiscal Investment and Loan Program, a separate capital budget. On the revenue side, higher-than-expected income will allow a drastic reduction in the amount of new government borrowing, and tax receipts are expected to show healthy growth. The budget illustrates how the new prime minister can work behind the scenes to achieve his policy objectives. Significant modifications

to the Ministry of Finance's proposed budget were made in the week between its submission and the cabinet's approval.

Mr. Takeshita is following his predecessor's practice of favoring a few general account spending areas while trying to reduce the current deficit. Leading the spending increase parade (see Table 1) is defense at 5.2 percent, followed by foreign aid (5.1 percent) and social security (2.9 percent). Although total spending for education will rise just 0.2 percent, outlays for science and technology (which are included in this total) will grow 4.2 percent. On the other hand, spending cuts are planned for food support programs (17.1 percent), energy projects (6.8 pecent), small business assistance (6.8 percent), and pensions (0.8 percent). Altogether, discretionary outlays will show a 1.2 percent gain to Y32,982.1 billion ($263.9 billion at Y125=$1.00), the first significant rise since FY 1984.

Table 1: Summary of FY 1988 General Account Outlays

(in billions of yen; change from initial FY 1987 budget)

Discretionary Items		
Social Security	Y10,384.5	2.9%
Education and Science	4,858.1	0.2
Pensions	1,879.8	-0.8
Defense	3,700.3	5.2
Public Works	6,017.3	0.0
Economic Cooperation	682.2	5.1
Disaster Reconstruction	65.1	0.0
Small Business Measures	195.2	-6.8
Food Control Programs	448.2	-17.1
Energy Measures	461.6	-6.8
Other	3,939.8	0.6
Reserves	350.0	0.0
Total	32,982.1	1.2
Nondiscretionary Items		
Transfers to Local Government	10,905.6	7.1
Debt Service	11,512.0	1.6
Transfer of NTT Proceeds to Public Works	1,300.0	*
Total	23,717.6	10.2
Total	56,699.7	4.8

*New category

Source: Ministry of Finance

The cost of servicing the nation's debt will rise 1.6 percent, well above the initial plan for the current fiscal year (0.1 percent) but far below the generally double-digit increases set during the FY 1980-FY 1986 period. Interest payments will therefore account for 20.3 percent of total outlays, down slightly from FY 1987's projected 20.9 percent level. Because of surplus FY 1987 tax receipts and projected revenue growth in fiscal 1988, transfers to

local governments (which are fixed at a percentage of total central government tax revenues) will jump 7.1 percent. Combined with proceeds from the sale of government-held shares of Nippon Telegraph and Telephone Corp., nondiscretionary spending will expand 10.2 percent.

At first glance it appears that public works expenditures will be held to FY 1987's Y6,017.3 billion ($48.1 billion) level. Thanks to the money earned from the sale of its NTT stock, however, Tokyo will actually spend more on roads, sewers and other infrastructures in FY 1988 -- just under Y1.3 trillion ($10.4 billion) more. The special addition translates into a sharp 21 percent increase in public investment, much of which is again likely to be spent during the first half of the fiscal year.

The stimulus provided by the general account will be solidly supported by Fiscal Investment and Loan Program outlays of Y29,614.0 billion ($236.9 billion), well above FY 1987's Y27,081.3 billion ($216.7 billion) initial level. Housing, public service facilities, roads, and trade promotion and economic cooperation will receive the lion's share of the increase (see Table 2). Unlike the general account budget, the FILP budget is funded mainly by government trust funds (see Table 3), although a handful of specific commodity taxes play a role.

Table 2: Fiscal Investment and Loan Program Outlays, FY 1987-FY 1988

(in billions of yen; change from initial budget of previous year)

	FY 1987		FY 1988	
	Amount	Change	Amount	Change
Housing	Y6,328.2	8.1%	Y6,921.5	9.4%
Public Service Facilities	3,998.7	8.2	4,450.9	11.3
Welfare	627.7	0.3	661.8	5.4
Education	784.1	15.6	637.6	-18.7
Small Business	3,985.6	7.7	4,030.6	1.1
Agriculture	907.8	0.6	979.4	7.9
Land Conservation and Disaster Reconstruction	493.0	16.6	409.8	-16.9
Roads	2,363.0	16.7	2,512.1	6.3
Transportation and Communications	2,264.1	12.4	2,229.9	1.5
Regional Development	657.7	16.2	652.2	-0.8
Industry and Technology	630.9	-0.0	687.2	8.9
Trade Promotion and Economic Cooperation	690.5	-33.2	1,171.0	69.6
Capital Utilization	3,350.0	*	4,270.0	27.6
Total	27,081.3	22.2	29,614.0	9.4

*New category

Source: Ministry of Finance

Table 3: Fiscal Investment and Loan Program Sources, FY 1987-FY 1988

(in billions of yen; change from intital budget of previous year)

	FY 1987		FY 1988	
	Amount	Change	Amount	Change
Industrial Investment Special Account	Y144.3	134.6%	Y91.2	-36.8%
Trust Fund Bureau	24,595.8	18.6	26,206.6	6.5
Postal Savings	7,900.0	12.9	7,900.0	0.0
Pension Contributions	4,450.0	3.5	3,500.0	-21.3
Other Revenues	12,245.8	29.7	14,806.6	20.9
Postal Life Insurance Fund	3,941.2	25.3	4,409.4	11.9
Government-Guaranteed Bonds and Borrowings	2,400.0	-25.2	2,406.8	2.8
Total	31,081.3	14.5	33,114.0	6.5

Source: Ministry of Finance

On the revenue side of the general account budget, tax receipts are expected to expand a strong 9.5 percent to Y45,090 billion ($360.7 billion) due to the recovery of corporate profits and the continuing boom in financial and real estate transactions. While another sale of lucrative NTT stock will pour an estimated Y2,768.7 billion ($22.1 billion) into government coffers in FY 1988, only Y1.3 trillion ($10.4 billion) will be explicitly included in the general account budget.

A total of Y8,841 billion ($70.7 billion) in bonds will be issued in FY 1988 (Y3,151 billion or $25.2 billion in deficit-financing bonds and Y5,690 billion or $45.5 billion in construction bonds), a whopping 15.8 percent decline from the figure originally projected for the current fiscal year. The reduction is composed of a Y1,830 billion ($14.6 billion) cut in new deficit-financing bonds and a Y170 billion ($1.4 billion) increase in construction bond issues. This will reduce reliance on bond issues to just 15.6 percent of total revenues, down sharply from this year's initial projection of 19.4 percent. If the government maintains this rate of deficit-financing reduction, it will achieve its goal of eliminating this type of borrowing by fiscal 1990.

Finally, receipts from other sources will drop 39 percent to Y1,468.7 billion ($11.7 billion), bringing total revenues to Y56,699.7 billion ($453.6 billion). Major changes in tax policy are not envisioned in FY 1988. Learning from his predecessor's experience, Mr. Takeshita is taking time to prepare a national consensus on tax reform (including a major indirect tax) before submitting legislation.

An important aspect of the FY 1988 general account budget was that it barely resembled the proposal submitted to the cabinet by the Ministry of Finance December 22 (see Table 4). In order to leave overall spending levels unchanged and bolster some categories, almost every discretionary item was adjusted. Since each ministry must approve the changes, Mr. Takeshita must have used his consensus-building skills to the fullest during the week of negotiations. It was an impressive display of the Takeshita style of government and could bode well for resolution of international frictions.

Table 4: Comparison of Proposed and Approved FY 1988 Discretionary Outlays

(in billions of yen)

	Proposed	Approved
Social Security	Y10,352.2	Y10,384.5
Education and Science	4,784.2	4,858.1
Pensions	1,859.1	1,879.8
Defense	3,670.6	3,700.3
Public Works	6,017.3	6,017.3
Economic Cooperation	672.1	682.2
Disaster Reconstruction	65.1	65.1
Small Business Measures	190.1	195.2
Food Control Programs	438.1	448.2
Energy Measures	460.2	461.6
Other	4,043.0	3,939.8
Reserves	350.0	350.0

Source: Ministry of Finance

Despite all the hoopla from Tokyo, some foreign observers are skeptical that the FY 1988 budget represents a significant change. They point out that the initial FY 1988 budget is on par with the revised spending plan for FY 1987 if the large supplementary budget is included (see JEI Report No. 25B, July 2, 1987). A comparison shows outlays for public works at Y7,211.3 billion ($57.7 billion) in FY 1987 versus Y7,282 ($58.3 billion) in fiscal 1988; Y408.6 billion ($3.3 billion) for disaster reconstruction compared to the Y65.1 billion ($521 million) planned for FY 1988; economic cooperation worth Y667.5 billion ($5.3 billion) in FY 1987 and Y682.2 billion ($5.5 billion) next fiscal year; suppport for small business should total Y238.7 billion ($1.9 billion) by March 31, 1988 with only Y195.2 billion ($1.6 billion) planned for the next 12 months; and miscellaneous outlays will amount to Y4,398.4 billion ($35.2 billion) in FY 1987 as opposed to a projected Y3,939.8 billion ($31.5 billion) in FY 1988.

At first glance the argument is well taken. The chances that the FY 1988 supplementary budget will not add to total outlays for the fiscal year is very small. (Disaster reconstruction in particular is allotted the majority of its funds in the supplementary budget.) How much it will add is the key question. If the economy needs a boost, Mr. Takeshita could put together a big supplementary spending package; if not, then the supplementary budget may be less. In any case, it is unlikely that the prime minister will allow FY 1988 spending to be less than FY 1987's adjusted level, particularly for technology promotion, defense, foreign aid and public works.

Jon Choy

Government Sees Continued Economic Expansion

Shaking off the effects of a rising yen, the Japanese economy is moving from a recovery phase into expansion, according to the fiscal 1988 economic outlook considered by the cabinet December 22. Real GNP is now expected to rise 3.7 percent in FY 1987, an upward revision from the December 1986 estimate of an inflation-adjusted 3.5 percent. Growth will increase slightly in FY 1988 to 3.8 percent. The figures are remarkably close to the private sector's average estimate of a 3.7 percent expansion in FY 1987 and a 3.6 percent gain in FY 1988.

The government's economic outlook is especially important since it establishes a framework for the budget. The Ministry of International Trade and Industry and the Finance Ministry disagreed about the appropriate growth target for FY 1988. MITI argued for 4 percent to conform to the medium-term figure recommended in the Maekawa report on economic restructuring. The Finance Ministry, worried about the larger government expenditures required to obtain faster growth, preferred a lower 3.6 percent. The Economic Planning Agency, acting as mediator, exactly split the difference, coming up with 3.8 percent.

The government anticipates a comparatively stable international economic situation during the April 1988-March 1989 period, with prices, including oil, rising slowly and interest rates remaining moderate. The outlook assumes the yen will trade at an average of 133 to the dollar, a rate that implies a reversal of the dollar's recent decline.

Government's FY 1988 Economic Outlook

(percent change except where noted)

	Actual FY 1986	Estimated FY 1987	Outlook FY 1988
Real Gross National Product	2.6%	3.7%	3.8%
Consumer Spending	3.6	3.6	3.8
Residential Construction	10.9	16.5	1.9
Capital Spending	4.5	7.1	9.8
Contribution of Domestic Demand to Change in Real GNP (percentage points)	4.1	5.0	4.7
Contribution of External Demand to Change in Real GNP (percentage points)	-1.5	-1.3	-1.0
Current Account Surplus (billions of dollars)	94.1	82.0	72.0
Wholesale Prices	-9.4	-1.7	0.3
Consumer Prices	0.0	0.7	1.3

Domestic demand, spurred by public works spending, is expected to propel the economy for the rest of FY 1987 and FY 1988. Included in Tokoyo's economic outlook is a long list of things the government would like to do. Some groups and industries are singled out for special attention: the aged, small and medium businesses, fisheries and forestry industries, mineral resources and knowledge-intensive activities, to name a few. The government reaffirmed Tokyo's dedication to free trade and pledged increased market access, liberalization of financial markets and a stronger commitment to international cooperation in basic research.

Both Japan's current account and trade surpluses are expected to continue to shrink. In FY 1988 the current account surplus is projected at $72 billion, a reduction of $10 billion from FY 1987's anticipated number and $22 billion below the actual FY 1986 figure. While declining surpluses drag down the rate of economic growth in Japan, so far their impact has been moderate compared to the positive contribution that net exports made to economic growth between 1982 and 1986. Even if the projection for the FY 1988 current account proves correct, in dollar terms it will still be the third-largest surplus in Japanese history.

Douglas Ostrom

Dollar Ends Depressing Year Still On The Skids

In the spirit of the season, governments here and abroad showered gifts on the currency markets in the hope that they in turn might show a little charity toward the dollar, but to little avail. The dollar ended 1987 as pathetically as it ended 1986 -- by dropping to another postwar low. In Tokyo the dollar closed the year at Y122, a 30.4 percent drop over 1986's yearend rate.

While most of the gifts arrived before Christmas, the markets still seemed to think they were too little and too late. For example, on December 22 President Reagan signed into law measures that, among other things, promised to reduce the U.S. budget deficit by about $33 billion in fiscal 1988, ending September 31, 1988, and by over $40 billion in fiscal 1989. The idea was Washington would borrow less and the U.S. economy would require less capital from abroad. Reduced foreign investment requirements call for a smaller spread between U.S. and overseas interest rates, a notion appealing to the Europeans and the Japanese because they would then face less pressure to lower their rates.

But many economists found little to cheer about in the deficit-reduction measures. They pointed out that the actual impact was even less than it appeared since certain of the mandated budget savings did not reduce domestic demands on capital markets.

The measures might reduce the Japanese trade surplus a little. In November Japan's Economic Planning Agency used its world economic model to estimate the impact of a U.S. deficit reduction somewhat larger than the one actually enacted. It showed that a cut of 1 percent of nominal gross domestic product (the actual reduction was no more than 0.7 percent), lasting for at least three years, would, by the third year, reduce Japan's trade surplus by about $6 billion a year, or 6 to 10 percent. While not a dramatic drop, the deficit-reduction program would do more to cut the Japanese trade surplus than many, if not all, of the market opening actions Washington has been pushing on Tokyo.